intends to impose some additional charge, or whether it will simply not provide the capability for CLECs to combine those elements.

BellSouth's South Carolina Revised SGAT states that BellSouth will perform, at no additional charge, software modifications that are "necessary" for the "proper functioning" of CLEC-combined elements, but it does not identify what translations are available under this provision or what the procedures are for obtaining these translations. BellSouth SC Revised SGAT at II.F.2.

Even more fundamentally, the BellSouth South Carolina Revised SGAT does not even specify what combinations of network elements it proposes to separate and require the CLEC to combine, a defect that will make it exceedingly difficult for a CLEC to plan for the use of such elements. Even CLECs that plan to use some facilities of their own will need to purchase some "sets" of facilities and functionalities, and if it is not known whether they will be provided as a single element or in several pieces, it would not be possible for new entrants to plan their business. Moreover, this SGAT does not state what charges, if any, would be levied by BellSouth to modify existing elements so that they may be combined.

While the BellSouth South Carolina Revised SGAT appears to acknowledge the need for methods and procedures for providing unbundled elements in a manner that would allow them to be combined, the critical details are unspecified, and appear to be left largely as subjects for future negotiation. This approach, in our view, is inconsistent with BellSouth's obligation to offer

specific and legally binding commitments with respect to its offering of unbundled elements.

This lack of clarity also precludes a finding that BellSouth is offering "nondiscriminatory" access to unbundled elements at the statutorily-required prices, as required by the checklist. For example, at least with respect to some combinations, it appears from the BellSouth South Carolina Revised SGAT that instead of providing requesting carriers with supervised access to its network to allow them to do the work of combining the BellSouth network elements, BellSouth would require a new entrant to collocate its own facilities in a central office in order to combine these elements.[31] In many cases, however, it would appear to be far less costly to allow CLECs to obtain supervised access to BellSouth's network so that they may perform the work of combining elements in a manner that would enable them to provide telecommunications services "entirely" with unbundled elements obtained from an incumbent, without contributing any facilities of their own.[32]

In the absence of any record concerning the costs or practical implementation issues

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[31] The only specific description in the SGAT that arguably addresses arrangements by which a competing carrier may combine unbundled elements specifies that BellSouth may deliver unbundled loops to CLEC collocation spaces. BellSouth SC Revised SGAT, at II.B.6.

[32] For example, unbundled loops and switching might be combined simply by connecting the loop from the customer's premises to the port of the local switch at the main distribution frame. It would appear that BellSouth could permit requesting carriers to have supervised access to its network to perform this simple operation without any substantial additional investment. A requirement that requesting carriers invest in additional collocation facilities in order to combine these elements might unnecessarily add costs to the provision of telecommunications services. The Department has reached no conclusions as to the requirements needed to ensure that unbundled elements may be combined. Our point is simply that BellSouth has not addressed these issues sufficiently, thereby precluding any finding that its offering is sufficient to satisfy this statutory requirement.

relating to alternative methods of providing unbundled elements so that they may be combined -- indeed in the absence of any clear indication of how BellSouth itself proposes to fulfill this statutory requirement -- we do not believe that BellSouth has demonstrated compliance with the checklist.

b. BellSouth Has Failed to Establish That It Is Operationally Ready to Provide Unbundled Network Elements in a Manner That Allows Requesting Carriers to Combine Them to Provide Telecommunications Services

BellSouth also must show that it has the practical capability of providing unbundled elements in a manner that permits them to be combined. At least some methods of meeting this requirement would appear to require the development and testing of new capabilities. In terms of implementing any arrangements necessary to combine elements, we would look to see how BellSouth would perform any additional functions necessary to allow elements to be combined by a CLEC. As it is not even clear what those practices will be, BellSouth has not yet demonstrated that it possesses the technical capability to satisfy this requirement in a reliable, commercially acceptable manner. Thus, for all the reasons stated above, BellSouth has not satisfied its burden of showing that it has the practical ability to provide these elements as required by the checklist.

c. If Competing Carriers Cannot Combine Unbundled Network Elements, Then Efficient Entry Would Be Seriously Impeded

BellSouth's failure to establish that it will offer unbundled elements in a manner that will allow other carriers to combine them to offer telecommunications services has substantial implications for the development of competition in South Carolina. The 1996 Act establishes a

legal right for competing carriers to combine unbundled network elements and to provide services entirely through the use of unbundled network elements, and the Commission repeatedly has emphasized the importance of that right for competition in local exchange and access markets.[33] However, the decision in Iowa Utilities Board to vacate rule 51.315(b) has created great uncertainty about the manner in which unbundled elements will be provided to CLECs, and in turn, the costs that CLECs will incur in combining them in order to provide services.

The resolution of these issues, of course, may be enormously important to promoting efficient competitive entry. The most economically efficient means for CLECs to serve a large segment of customers in the foreseeable future may be through the use of combinations of unbundled elements, whether a CLEC uses only combinations of elements purchased from incumbent LECs, or uses such elements in conjunction with network elements of its own. If appropriate means can be found to ensure that elements are provided in a manner that allows CLECs to combine them without large expenditures, alternative providers of local services may be able to serve many consumers using unbundled elements. Conversely, if unbundled elements are provided in a manner that requires CLECs to incur large costs in order to combine them, many customers -- especially residential customers -- may not have any facilities-based competitive alternative for local service for a considerably longer period of time.

In light of the substantial competitive implications of this issue, we believe that a BOC should be required to clearly articulate the manner in which it proposes to offer unbundled

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[33] 47 U.S.C. § 251(c)(3); Michigan Order ¶¶ 332-33.

elements so that they may be combined and demonstrate that it has the practical ability to process orders and provision them in that manner. Moreover, in the absence of a more complete record on which to evaluate the issue, we are particularly concerned about proposals to relegate these issues to a bona fide request procedure, as BellSouth proposes in this application. Such a procedure may be both necessary and desirable for dealing with a variety of access and interconnection issues involving new services or unusual circumstances, but the bona fide request process sometimes may serve only to create additional opportunities for delay and litigation. It should not serve as a substitute for demonstrating the availability of basic checklist requirements.

The implication in BellSouth's South Carolina revised SGAT that it will require CLECs to establish collocation facilities in order to combine elements also has important competitive ramifications. Such a requirement would entail substantial cost and delay for CLECs wishing to use combinations of elements.[34]

In short, BellSouth's failure to show checklist compliance in this area should not be regarded as a mere technicality. Rather, that failure carries with it a substantial threat to the viability of competition using unbundled network elements, one of the key entry vehicles established by the 1996 Act.

D. BellSouth's Wholesale Support Processes Are Deficient

Efficient wholesale support processes -- those manual and electronic processes, including

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[34] For example, DeltaCom, the only CLEC pursuing physical collocation in South Carolina, states that it will have taken more than a year to negotiate and implement its collocation arrangement. Moses Aff. ¶ 19.

access to OSS functions, that provide competing carriers with meaningful access to resale services, unbundled elements, and other items required by section 251 and the checklist of section 271 -- are of critical importance in opening local markets to competition. As explained in the Michigan Order, the Commission employs a two-part standard in evaluating checklist compliance with respect to OSS access. Michigan Order ¶ 136.

First, it will consider "whether the BOC has deployed the necessary systems and personnel to provide sufficient access to each of the necessary OSS functions and whether the BOC is adequately assisting competing carriers to understand how to implement and use all of the OSS functions available to them." Id. As to the *functionality* of those systems, the Commission determined that "[f]or those functions that the BOC itself accesses electronically, the BOC must provide equivalent electronic access for competing carriers" and that "the BOC must ensure that its operations support systems are designed to accommodate both current demand and projected demand of competing carriers for access to OSS functions." Id. ¶ 137. As to the *support* of those systems, the Commission made particularly detailed determinations:

> A BOC ... is obligated to provide competing carriers with the specifications necessary to instruct competing carriers on how to modify or design their systems in a manner that will enable them to communicate with the BOC's legacy systems and any interfaces utilized by the BOC for such access. The BOC must provide competing carriers with all of the information necessary to format and process their electronic requests so that these requests flow through the interfaces, the transmission links, and into the legacy systems as quickly and efficiently as possible. In addition, the BOC must disclose to competing carriers any internal "business rules," including information concerning the ordering codes [including universal service ordering codes ("USOCs") and field identifiers

> ("FIDs")] that a BOC uses that competing carriers need to place orders through the system efficiently.

Id. (footnotes omitted).

Second, the Commission will consider "whether the OSS functions that the BOC has deployed are operationally ready, as a practical matter." Id. ¶ 136. Here, "the Commission will examine operational evidence to determine whether the OSS functions provided by the BOC to competing carriers are actually handling current demand and will be able to handle reasonably foreseeable demand volumes." Id. ¶ 138. The Commission has stated that the "most probative evidence" of operational readiness is actual commercial usage and that carrier-to-carrier testing, independent third-party testing, and internal testing, while they can provide valuable evidence, "are less reliable indicators of actual performance than commercial usage." Id.

The Commission's OSS standards reflect the fact that entrants relying on unbundled network elements or resale will also be dependent on incumbents' provision of efficient and reliable operations support systems. An aggregation of "minor" OSS problems may, collectively, place entrants at a substantial competitive disadvantage to BellSouth, because they would prevent those entrants -- regardless of their own efforts -- from marketing and providing services with the same degree of efficiency, reliability, and quality offered by BellSouth.

When the Commission evaluates OSS issues prior to the "stress testing" provided by actual commercial use at competitively significant volumes, it must make difficult predictive judgments about the likely commercial significance of an applicant's failure to provide OSS functionality that is identical or precisely comparable to the functionality available for the

applicant's own use. Actual commercial use may indicate in some cases that isolated limitations in OSS offerings will not materially impact competition. For that reason, we do not believe that the Commission should require "perfection" in OSS offerings as a condition of section 271 approval. However, when evidence from commercial use at competitively significant volumes is unavailable, as is the case here, the Commission should continue to examine carefully all concerns about the adequacy of OSS offerings. It is precisely because these complex issues are so difficult to evaluate, and because of their substantial competitive impact, that the Commission should insist that potentially significant OSS problems be resolved *before* the BOCs enter the interLATA market. Regulatory solutions in this area will be exceedingly difficult if the BOCs themselves have no incentives to resolve these problems.[35]

BellSouth's present application falls well short of satisfying the standards articulated by the FCC. Although BellSouth has devoted substantial resources to the development and implementation of the requisite systems, much additional work remains to be done. As to the current interfaces offered by BellSouth for pre-ordering and ordering functions, we conclude that BellSouth has failed to demonstrate that they will allow for effective competition, and BellSouth's ongoing efforts to address our concerns on this score are still incomplete. The record indicates numerous complaints from CLECs that they have not yet been able to obtain sufficient information from BellSouth to permit them to complete the development of their own OSSs.

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[35] See Schwartz Aff. ¶¶ 126-140, 154-157, 179-182; and Supplemental Affidavit of Marius Schwartz on Behalf of United States Department of Justice ¶¶ 35-43 ("Schwartz Supp. Aff."), attached to this Evaluation as Exhibit 2.

BellSouth's systems have experienced little commercial use, but that limited experience suggests potentially serious system inadequacies that have not yet been fully addressed. Moreover, the limited capacity of key systems suggests that performance problems are likely to be far more serious when competitors begin to order unbundled elements or resale services in competitively significant volumes. As explained in Appendix A, attached to this Evaluation and in the Friduss South Carolina Affidavit, attached to this Evaluation as Exhibit 3, BellSouth's failure to institute all of the necessary wholesale performance measurements,[36] prevents a determination that BellSouth is currently in compliance with checklist requirements or that compliance can be assured in the future.

In concluding that BellSouth has failed to comply with the checklist requirements governing OSS, we are mindful of the SCPSC's contrary conclusion. That conclusion was reached, however, before the Commission provided its detailed decision on OSS issues in the Michigan Order. Indeed, other state commissions in the BellSouth region, including the Alabama and Georgia commissions and the staff of the Florida commission, have expressed serious concerns about the adequacy of BellSouth's systems in the wake of the Commission's Michigan Order.[37]

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[36] Affidavit of Michael J. Friduss - South Carolina ¶¶ 77-78 ("Friduss SC Aff."), attached to this Evaluation as Exhibit 3.

[37] See Alabama Public Service Commission, In re Petition for Approval for a Statement of Generally Available Terms and Conditions Pursuant to §252(f) of the Telecommunications Act of 1996 and Notification of Intention to File to Petition for In-Region, InterLATA Authority with the FCC Pursuant to §271 of the Telecommunications Act of 1996, Docket 25835, Order (Oct. 16, 1997) ("Alabama Order"); Florida Public Service Commission, In

Although BellSouth's OSS fails to satisfy checklist requirements, we are encouraged by some aspects of BellSouth's OSS efforts, particularly by BellSouth's work with an independent software vendor to develop an inexpensive, PC-compatible software package that is compatible with BellSouth's EDI interface.[38] BellSouth states that it undertook this work "[t]o assist CLECs of all sizes that want to use EDI without extensive development effort on their side of the EDI interface" and that the software "is readily available to even the small CLEC." Id. The Department supports this approach, which can benefit both CLECs and BOCs by making multiple alternatives available to CLECs while requiring the BOC to support only a single interface on its end. Moreover, such software has the potential, if combined with integrated support for an application-to-application pre-ordering interface, to provide even the smallest CLEC with an integrated pre-ordering/ordering environment such as that presently used by BellSouth's retail representatives.

In Appendix A to this Evaluation, we explain in greater detail numerous concerns about BellSouth's performance and capabilities in providing access to OSS, as well as its deficiencies in reporting wholesale performance. In short, based on the record in this application, we cannot conclude that BellSouth has demonstrated that it satisfies the checklist requirements relating to its

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re Consideration of BellSouth Telecommunications, Inc.'s Entry into InterLATA Services Pursuant to Section 271 of the Federal Telecommunications Act of 1996, Docket No. 960786-TL, Staff Recommendation (Oct. 22, 1997) ("FPSC Staff Recommendation"); "Telephony," Communications Daily, Oct. 30, 1997 ("GAPSC Article").

[38] Affidavit of William N. Stacy, Checklist Compliance (Operations Support Systems) ¶ 53 ("Stacy OSS Aff."), attached to BellSouth's Brief as Appendix A-Volume 4a, Tab 12.

operations support systems.

III. The South Carolina Market Is Not Fully and Irreversibly Open to Competition

The 1996 Act requires the Commission to consult with the Attorney General on all applications under section 271, and authorizes the Attorney General to provide an evaluation of such applications "using any standard the Attorney General considers appropriate."[39] The 1996 Act does not limit the Department's evaluation to any of the specific findings that the Commission is required to make, under section 271(d)(3), before approving an application. Indeed, it does not limit the evaluation to those findings, collectively, though of course the evaluation may be relevant to any or all of those findings. In any event, the Commission is required to accord "substantial weight" to the Department's evaluation.

The Department has concluded that it should evaluate section 271 applications under a standard that requires an applicant to show that the markets in a state have been fully and irreversibly opened to competition. A detailed explanation of that standard, and the reasons the Department has adopted it, is provided in the attached Affidavit and Supplemental Affidavit of Dr. Marius Schwartz, and in previous evaluations submitted by the Department.[40]

In the absence of broad-based commercial entry using the three entry paths contemplated by the 1996 Act, the Department will closely examine competitive conditions in a state, to determine whether significant barriers to competition have been removed, and whether there are

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[39] 47 U.S.C. §271(d)(2)(A).

[40] See DOJ Oklahoma Evaluation at 36-51; DOJ Michigan Evaluation at 29-31.

objective criteria to ensure that competing carriers receive appropriate access to essential inputs, even after an application under section 271 has been approved. Under this standard, BellSouth has not shown that the market in South Carolina is fully and irreversibly open to competition, and its application should be denied.

A. The Minimal Level of Competition in South Carolina Does Not Provide Evidence That Local Markets Are Fully and Irreversibly Open

At this time, BellSouth faces no significant competition in local exchange services in South Carolina. The competitive situation in South Carolina is reviewed in more detail in Appendix B to this Evaluation. We are not aware of any operational facilities-based local exchange competitor at the present time. As of September 11, 1997, only 573 residential lines and 1785 business lines had been resold in the entire state.[41] Of the 573 resold residential lines identified in BellSouth's application, over 90% were resold by a single company, which has only a resale arrangement with BellSouth, and, therefore, would presently be unable to provide facilities-based competition. The resale of lines to business is only slightly more robust and diverse. Eleven companies are reselling at least a single business line, though three companies account for approximately 98% of BellSouth's 1785 resold lines.

Despite the limited operations today of competitors, a substantial number of companies have expressed an interest in providing local services in the state. As of the date of BellSouth's application, 83 telecommunications carriers had executed agreements with BellSouth, and sixteen companies had been certified to provide competing local telephone service in South Carolina.

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[41] Wright Aff. ¶ 24.

Seven of those companies -- ACSI, AT&T, DeltaCom, Hart Communications, Intermedia, KMC Telecom, and MCI -- have approved interconnection agreements for services other than resale. Two companies -- ACSI and DeltaCom -- are moving towards the provision of facilities-based local service.

ACSI currently provides non-switched dedicated services, including special access, data services, and private line services, over its own fiber optic facilities in Columbia, Charleston, Greenville, and Spartanburg. ACSI plans to have an operational switch in Greenville during in the first quarter of 1998, which it will use to serve business customers. ACSI is currently providing resold services to a small number of business customers in South Carolina. ACSI has not yet purchased UNEs from BellSouth, but plans to do so when its switch is operational.

As noted in Part I, DeltaCom has indicated that it plans to provide facilities-based local exchange services, and has been moving towards fulfilling that plan.[42] It plans to do so either through the use of a network entirely owned by DeltaCom or through the partial use of BellSouth facilities.[43]

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[42] Moses Aff. ¶ 22.

[43] AT&T and MCI have expressed their intention to provide local exchange services to both residential and business customers in the state using either unbundled network elements or resale. AT&T requested unbundled network elements from BellSouth in March 1996 and interconnection in June 1996 to provide local exchange services via resale, unbundled network elements, and on a facilities basis in South Carolina. A final arbitrated agreement between AT&T and BellSouth was approved on June 20, 1997; AT&T objected to several of the agreement's provisions and filed an appeal with the U.S. District Court of South Carolina on July 18, 1997. AT&T has not begun to provide any local telecommunication services in South Carolina, according to AT&T, because of BellSouth's OSS inadequacies, the lack of cost-based pricing for combined unbundled network elements, and the very low wholesale discount rate.

Given the current minimal level of competition in South Carolina, despite the apparent interest in entering South Carolina by a significant number of competitors, there is no reason to presume that the market is fully open to competition. Therefore, we examine competitive conditions more carefully to see whether any significant barriers continue to impede the growth of competition in South Carolina.

B. Substantial Barriers to Resale Competition and Competition Using Unbundled Elements Remain in Place in South Carolina

As noted above, only two companies, ACSI and DeltaCom, appear to be making substantial efforts at this time to construct new telecommunications networks in South Carolina. These companies, when they become fully operational, may provide important competitive alternatives for consumers, but overall, investment in new facilities appears to have been relatively less attractive to CLECs in South Carolina than in some other states, a fact that may well reflect the demographic and economic characteristics of the state.

The limited investment in new facilities means that for the immediately foreseeable future, competition to serve the large majority of South Carolina consumers -- most residential customers and customers of all kinds outside of the largest urban areas of the state -- can occur only through resale or the use of unbundled network elements. Competitors seeking to use those two entry vehicles will be critically dependent on BellSouth.

MCI has only recently entered the South Carolina market. MCI's interconnection agreement, based in part on the terms obtained by AT&T in its arbitration order, contemplates the purchase of unbundled network elements from BellSouth. According to MCI, plans to provide local exchange service in South Carolina are not progressing because of the lack of adequate OSS and the inability of BellSouth to provision unbundled network elements.

As explained in Parts II.C, and D of this Evaluation, BellSouth has failed to show that competitors can be assured of appropriate access to essential inputs, i.e., that they will receive unbundled elements from BellSouth in a manner that allows them to combine those elements, and that they will have the legally-required access to OSSs that will permit them to compete effectively through the use of resale or unbundled elements. In addition to those deficiencies, BellSouth has failed to show that unbundled elements are currently offered, or will be offered in the future, at prices that will permit entry and effective competition by efficient firms, and has failed to show that it will provide objective measures of its wholesale performance that will ensure that competitors receive nondiscriminatory access to inputs now and in the future.

1. BellSouth Has Not Demonstrated That Current or Future Prices for Unbundled Elements Will Permit Efficient Entry or Effective Competition

Competition through the use of unbundled network elements will be seriously constrained, and may even be impossible, if those elements are not available at appropriate prices. In evaluating pricing arrangements as part of its competitive assessment, the Department will ask whether a BOC has demonstrated that its current prices are, and future prices will be, supported by a reasoned application of an appropriate methodology.

Reasoned Application Of An Appropriate Methodology. In order to conform to the Act, rates for interconnection and access to unbundled elements must be "just, reasonable, and nondiscriminatory," 47 U.S.C. §251(c)(2)(D), see also 47 U.S.C. §252(d)(1), (1)(A)(ii), and "based on the cost (determined without reference to a rate-of-return or other rate-based

proceeding) of providing the interconnection or network element (whichever is applicable)," 47 U.S.C. §252(d)(1)(A)(i); such rates "may include a reasonable profit," 47 U.S.C. §252(d)(1)(B). There have been no judicial decisions concerning the types of rate-making methodologies that are consistent, or inconsistent, with these statutory requirements. In our view, however, there are a variety of forward-looking cost methodologies that are consistent with the statutory requirements, and with the Department's standard for evaluating whether markets are fully and irreversibly open to competition.

Such methodologies, if properly applied, will create incentives for efficient investment by incumbents and potential entrants; will permit effective competition by new entrants on an equal footing, in which the relative efficiency of entrants and incumbents is suitably rewarded by the marketplace; and will stimulate price competition and service improvement for consumers. As well established economic principles make clear, forward-looking costs govern prices and entry decisions in competitive markets, and thus, those principles best promote competition in a market moving from a regulated monopoly to a competitive market.[44]

A variety of forward-looking methodologies also are likely to lead to prices that are "nondiscriminatory." As we have previously explained, the real cost of a network element to a

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[44] See, e.g., Stigler, G., The Theory of Price III (4th ed. 1987); Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98 and 95-185, FCC 96-325, ¶ 705 & n.1716 (rel. Aug. 8, 1996) ("Local Competition Order"). See also Duquesne Light Co. v. Barasch, 488 U.S. 299, 308 (1989) (ratemaking on the basis of forward-looking costs "mimics the operation of the competitive market"); MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1116-17 (7th Cir.), cert. denied, 464 U.S. 891 (1983) ("it is current and anticipated cost, rather than historical cost, that is relevant to business decisions to enter markets and price products").

BOC will be its own forward looking economic cost; charging a higher price to its competitor therefore may be discriminatory and anticompetitive.[45] Prices based on forward-looking economic costs will allow a BOC to obtain the "reasonable profit" allowable under the Act; monopoly profits a BOC might seek at its competitors' expense, thereby depriving customers of the benefits of cost-based prices, would be excluded.

Recognizing that the use of forward-looking cost methodologies is consistent with the 1996 Act and will further its procompetitive purposes and benefit consumers, a significant number of state PUCs have chosen to adopt such methods, see e.g., Local Competition Order ¶ 681, n.1687,[46] as has the Commission,[47] and other federal administrative agencies in related contexts.[48] Of course, the label attached to a particular methodology is not determinative; it is the substance

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[45] Comments of the United States Department of Justice, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, at 28-30 (filed May 16,1996) ("DOJ Local Competition Comments").

[46] According to a recent NARUC report, Telecommunications Competition 1997, Table 4 (Sept. 1997), 32 of 51 reporting commissions have said that they employ some form of forward-looking cost based pricing, including TELRIC or TSLRIC, while 18, including South Carolina, have not adopted such a pricing methodology. The Department does not express an opinion on whether states' characterizations of their pricing methodologies as based on forward looking costs in this report are accurate.

[47] Michigan Order ¶¶ 289-294.

[48] In recent years, for example, the Interstate Commerce Commission and its successor, the Surface Transportation Board, have regulated railroad rates on the basis of forward-looking costs. See, e.g., West Tex. Util. Co. v. Burlington N.R.R., No. 41191, 1996 WL 223724 (I.C.C.) (S.T.B. May 3, 1996), aff'd 114 F.3d 206 (D.C. Cir. 1997); Bituminous Coal -- Hiawatha, Utah, to Moapa, Nevada, 10 I.C.C. 2d 259 (1994); Omaha Pub. Power Dist. v. Burlington N.R.R., 3 I.C.C. 2d 123 (1986).

that counts.

If the prices for unbundled network elements in a state are derived through a methodology other than a forward-looking economic cost methodology, we could not conclude that market is fully open to competition unless, after careful consideration of the reasoning behind the prices on a case-by-case basis, we were able to determine that the alternative standard on which prices are based is consistent with the 1996 Act and permits entry and effective competition by efficient firms.[49]

Some ratemaking methods that were designed to operate in and to preserve a regulated monopoly environment would seem to be fundamentally inconsistent with that standard. For example, use of the "Efficient Component Pricing Rule" to establish prices for unbundled network elements would insulate a BOC's retail prices from competition, thereby discouraging entry in markets where current retail prices exceed competitive levels.[50] Such effects would impede the transition from regulated monopoly telecommunications markets to de-regulated, competitive

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[49] The 1996 Act also requires that all retail services be made available for resale at a wholesale discount (47 U.S.C. §251(c)(4)), and requires states to set the wholesale discount based on an "avoided" cost methodology (47 U.S.C. §252(c)(3)). It follows that a state must also explain how it has set the resale discount consistent with the 1996 Act, including articulating the methodology it has used and how it has applied the methodology. Issues have been raised by several commenters about whether BellSouth's 14.8% resale discount is consistent with the 1996 Act. While the Department does not analyze that issue in this evaluation, as there are several other grounds for denial of the application, this pricing issue would have to be considered before any approval of entry in South Carolina would be possible.

[50] See, e.g., In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Reply Comments of the United States Department of Justice, CC Docket No. 96-98, at 11-13 (filed May 30, 1996) ("DOJ Local Competition Reply Comments")

markets, and would deprive consumers of the benefits of price competition and new investments in telecommunications services.

Similarly, in the pre-Act regulated monopoly environment, universal service objectives were often promoted by insulating incumbent LECs from competition so that they could charge prices substantially above cost for some services, and use the resulting revenues to provide other services at or below cost. At least in some cases, if unbundled network elements are priced above cost, competitors could be discouraged from entering, or if they did enter, could be forced to bear a disproportionate share of the cost of supporting universal service objectives. In any event, their ability to compete on the merits would thereby be impaired.[51]

Whatever methodology is used, a reasoned application to the particular facts is needed. We expect that in most cases, a BOC will be able to demonstrate this by relying on a reasoned pricing decision by a state commission. However, if a state commission has not explained its critical decisions, or has explained them in terms that are inconsistent with procompetitive pricing principles, the Department will require further evidence that prices are consistent with its open-market standard.

Future Prices. Expectations concerning future prices can be as important, or even more important, than current prices. A market will not be "irreversibly" open to competition if there is a substantial risk that the input prices on which competitors depend will be increased to

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[51] All providers of telecommunication services, including but not limited to those that use unbundled elements, "should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." 47 U.S.C. § 254(b)(4).

inappropriate levels after a section 271 application has been granted. Such a price increase obviously could impair competitive opportunities in the future. As important, a substantial *risk* of such a price increase can impair competition *now*. Competitors that wish to use unbundled elements in combination with their own facilities will incur significant sunk costs when they invest in their own facilities. Such investment will not be forthcoming *now* if there is a substantial risk that increases in the prices for complementary assets, i.e., unbundled elements, will raise a competitor's total costs to a degree that precludes effective competition.

This does not mean that the prices must be permanently unchangeable. Such rigidity would be undesirable, both because costs change over time, and because adjustments to rate-making methodologies may be appropriate as market conditions change. However, competitors must have sufficient confidence about future prices to justify prudent investments in entry.[52] The basis for such confidence may be provided either by a BOC or by a state commission, through a variety of mechanisms such as long-term contractual arrangements, commitments to appropriate methodologies, and the like. Without some basis for confidence that future prices will be appropriate, we will not consider a market to be fully and irreversibly open to competition.

Pricing of Unbundled Elements in South Carolina. In South Carolina, BellSouth has not demonstrated that current prices permit entry and effective competition by efficient firms, and there is great uncertainty concerning the prices that will be available in the future. Given this

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[52] As Professor Schwartz explained in his affidavit, "[p]rohibitively high prices would render the new access arrangements [i.e., to unbundled network elements] meaningless; to permit efficient local entry, entrants must have adequate assurance that BOC prices for these inputs will remain reasonable and cost-based after interLATA relief is granted." Schwartz Aff. ¶ 22.

uncertainty, it is not surprising that there is no real competition using unbundled elements now, or that competitors' plans to compete in the future are subject to many contingencies.

BellSouth has not attempted to establish independently, in this proceeding, that it offers appropriate prices for unbundled elements. Instead, it relies solely on the determinations of the SCPSC, which it erroneously characterizes as "definitive" or "conclusive" for purposes of its application.[53] However, based on the record in this proceeding, we do not believe the conclusions of the SCPSC, standing alone, support a finding that the market in South Carolina is fully and irreversibly open to competition.

The SCPSC has not articulated a forward-looking cost methodology. Indeed, it has stated that it "has not adopted a particular cost methodology." SCPSC Order at 56. Instead, the prices contained in the SGAT were incorporated from several sources, including the BellSouth/AT&T arbitration, existing tariff rates, and rates negotiated in interconnection agreements with other carriers. Id. at 53. There is no explanation of the costs on which they are based.[54]

With respect to the rates derived from the BellSouth/AT&T arbitration, the SCPSC states

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[53] BellSouth Brief, at 37, 40.

[54] For example, the current wholesale rate structure in South Carolina for unbundled network elements does not include any variation in prices according to the actual costs in unbundled network elements across the state or any explanation as to when such geographically deaveraged prices would become available. In states with significantly varying loop densities, for example, we would expect there to be different unbundled loop prices made available to competitors. We recognize that the process of de-averaging may need to be accomplished over some transition period, but encouraging efficient entry requires that cost-based wholesale rates are the objective of a wholesale pricing structure. The SCPSC has not attempted to explain its departure from this approach here.

only that the rates were "within the bounds" of the cost studies provided by the parties in that arbitration, and that "many" of the rates were within the Commission's proxy rate ranges. Id. at 55. As to prices derived from negotiated interconnection agreements, the SCPSC states only that such rates "were certainly not set by the parties without reference to the cost of the services to be provided." Id. And the SCPSC offers no explanation for its conclusion that rates derived from preexisting tariffs conform to the cost-based pricing requirements of the 1996 Act.

These explanations are surely insufficient to demonstrate that BellSouth's unbundled element prices will permit efficient competition. While there is no single cost methodology that is required, surely some consistently applied methodology is needed.[55] In weighing conflicting cost studies presenting by opposing parties, there must be some reasoned explanation for a decision to accord greater weight to one rather than the other.

The fact that a rate has been negotiated in an interconnection agreement provides no basis for concluding that such a rate is competitively appropriate on a permanent basis for all parties. As the Commission has recognized, incumbent LECs may be able to exercise substantial market power in such negotiations.[56] Potential entrants may accept rates substantially in excess of cost, particularly if by doing so they can avoid the substantial cost and delay of arbitration proceedings,

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[55] See DOJ Oklahoma Evaluation, at 61 ("The [Oklahoma Corporation Commission] arbitrator's decision on the AT&T application did not recommend 'any particular methodology or cost study be adopted at this time.'").

[56] Local Competition Order ¶ 55. See also Schwartz Aff. ¶ 188 ("There is great asymmetry in these bargaining powers--since the dominant incumbent is content to preserve the status quo, while the entrant is clamoring for an agreement.").

or secure more favorable terms with respect to other provisions of their agreement.

The problems with current unbundled element prices are compounded by the great uncertainty concerning future prices. The SCPSC has expressly refused to articulate the methodology, if any, that it will use to establish "permanent" rates, and thus there is no assurance that the "permanent" rates will permit efficient competition using unbundled elements. The "true up" and "price cap" mechanisms in place in South Carolina do not solve these problems. To the extent BellSouth relies on the subsequent "true-up" of current prices to conform to final prices, as a safeguard against excessive current prices, this would not apply to many of the prices in the SGAT, such as those derived from pre-existing tariffs, that are not subject to "true-up". Moreover, where no methodology for permanent pricing has been established a "true-up" only leads to additional uncertainty as to what prices competitors ultimately will have to pay for elements ordered in the interim. The SCPSC's "price cap" on those prices subject to true-up does not adequately address this uncertainty as it only limits, at most, increases on elements already ordered, not prospective price increases on elements generally, which could end up being priced substantially higher than the interim rates. Thus, these mechanisms do not preclude the possibility that in the near future, unbundled element prices may increase significantly, in ways that are both unpredictable and anticompetitive.[57]

In short, the record in this application does not establish that either current or future prices

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[57] See DOJ Oklahoma Evaluation at 62 ("Since it is not yet known what the final Oklahoma prices will be or how they will be determined, the provision for a true-up is hardly sufficient assurance that competitors will in fact be charged cost-based prices now or later.").

for unbundled elements will permit efficient firms to enter and compete effectively. Because of this deficiency, we cannot conclude that the market is fully and irreversibly open to competition using unbundled elements.

The Commission Has Authority To Take Account of Pricing. Although BellSouth apparently concedes that a state commission's conclusions do not bind the Commission as to Track A/ Track B issues, nonprice elements of the checklist, or the public interest test, it argues that "[t]he SCPSC's pricing determinations are conclusive" for section 271 purposes and that the Commission lacks authority to take account of a state's wholesale pricing structure.[58] From the Department's standpoint, this argument is plainly wrong, as the 1996 Act mandates that the Department undertake a competitive assessment using "any standard the Attorney General considers appropriate"[59] and that the Commission must give "substantial weight" to this Evaluation.[60] In our view, an assessment about whether the local market has been "fully and irreversible opened to competition"--the inquiry we deem appropriate under this statutory mandate--necessarily requires some assurance that the prices in place--and which will continue to be available--reflect procompetitive pricing principles. The Commission is free to give effect to our Evaluation about the pricing structure however it chooses; but in order to follow the statutory directive of giving substantial weight to our Evaluation, the Commission must retain--by

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58 BellSouth Brief, at 37.

59 47 U.S.C. §271(d)(2)(A).

60 Id.

necessary implication--the authority to do so in exercising its authority under section 271.

2. Bell South Has Failed to Institute Performance Measurements Needed to Ensure Consistent Wholesale Performance

A conclusion that a market has been "fully and irreversibly opened to competition" requires both a demonstration that the competitive conditions currently in place will foster efficient competition, as well as assurances that those conditions will remain in place after a section 271 application has been granted. In terms of wholesale performance -- where a BOC's systems will be critical to enabling its competitors to succeed in the marketplace -- an appropriate means of "benchmarking" performance is needed. As we have explained previously, we examine whether a BOC has established (1) performance measures and reporting requirements so that wholesale performance can be measured; (2) performance standards -- i.e., commitments made by the BOC as to its anticipated levels of performance; and (3) performance benchmarks -- i.e., a track record of performance. These steps will permit an assessment of current performance and will enable competitors and regulators to more effectively address any post-entry "backsliding" from prior performance through contractual, regulatory, or antitrust remedies.

BellSouth has made several important commitments to gather and maintain performance data. First, BellSouth has implemented a data warehouse, separate from the mainframe computers on which its OSSs run, in which raw data relating to performance can be stored and through which it can be queried and analyzed.[61] Second, BellSouth states that it is capturing for

[61] Affidavit of William N. Stacy, Checklist Compliance (Performance Measures) ¶ 13 ("Stacy Performance Aff."), attached to BellSouth Brief as Appendix A-Volume 5, Tab 13.